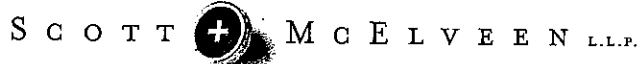


Report on Audits of Financial Statements of
South Carolina Universal Service Fund
for the years ended December 31, 2007 and 2006

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Independent Auditors' Report

South Carolina Office of Regulatory Staff
Columbia, South Carolina

We have audited the accompanying financial statements of the South Carolina Universal Service Fund (the "Fund") as of and for the years ended December 31, 2007 and 2006, as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of the Fund are intended to present the financial position and results of operations of the Fund and do not purport to and do not present fairly the financial position of the State of South Carolina and the changes in its financial position or cash flows for the periods then ended in conformity with accounting principles generally accepted in the United States of America, and do not include any other agencies, divisions or component units of the State of South Carolina.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the Fund as of December 31, 2007 and 2006, and the respective changes in financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the financial statements of the Fund. The management's discussion and analysis on pages 3 thru 6 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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Member: AICPA, SCACPA, SEC Practice Section
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In accordance with *Government Auditing Standards*, we have also issued a report dated October 21, 2008, on our consideration of the Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Scott McElveen, L.L.P.

Columbia, South Carolina
October 21, 2008

Required Supplementary Information

South Carolina Universal Service Fund Management's Discussion and Analysis

Management's Discussion and Analysis ("MD&A") is prepared by the Office of Regulatory Staff (the "ORS") management to provide general information on the financial activities of the Fund. The MD&A should be read in conjunction with the Fund's financial statements and accompanying notes. The financial statements, notes, and this discussion are the responsibility of ORS's management.

The South Carolina Office of Regulatory Staff is an independent regulatory agency of the State of South Carolina that is responsible for representing the public interest in the regulation of public utilities, including electric, natural gas and telephone. The ORS receives its authority and responsibilities from the State Legislature. One of the ORS's responsibilities is to administer the Fund. The Fund was established to ensure the widespread availability of affordable local exchange telephone service.

This section of the Fund's financial report represents our discussion and analysis of the financial performance during the periods presented. It should be read in conjunction with the Fund's financial statements, which follow this section.

Overview/Discussion of the Financial Statements

The Fund is accounted for as a special revenue fund, which is a governmental fund that uses the flow of current financial resources and the modified accrual basis of accounting. The financial statements provide a detailed short-term view of the Fund's finances that assists in determining whether there will be adequate resources available to meet the current needs of the Fund. The Fund's financial statements include two statements:

The Balance Sheets/Statements of Net Assets (Deficit) present only assets expected to be used and liabilities that come due during the year or soon thereafter. The difference between assets and liabilities is reported as fund balance (deficit)/net assets (deficit).

The Statements of Revenues, Expenditures, and Changes in Fund Balance (Deficit)/Statements of Activities present a comparison of revenues for which cash is received during or soon after the end of the year; expenditures for which payment is due during the year or soon thereafter; and other financing sources and uses, such as transfers to the General Fund. The net of these categories increases or decreases the fund balance (deficit).

This annual report consists of two parts – management's discussion and analysis and the basic financial statements. The basic financial statements also include notes that explain key information contained in the financial statements and provide further details on select data.

Financial Highlights

In November 2006, the Fund was resized to eliminate its fund deficit which was \$838,090 at December 31, 2006. In addition many outstanding accounts receivable issues from prior years were resolved during 2007 resulting in gross accounts receivable decreasing from \$3,474,448 to \$1,208,795. The resizing and the Fund's continued efforts at collecting accounts receivable resulted in an excess of revenues over expenditures of \$1,047,968 for the year ended December 31, 2007. Applying this surplus to the prior fund deficit resulted in a fund balance of \$209,878 at December 31, 2007.

Currently Known Facts/Economic Factors

- Assessable revenues reported during 2007 were down. Several factors contributed to this decline including:
 - The South Carolina Public Service Commission's decision to exclude revenues from international calling for assessment purposes
 - South Carolina consumer migration to alternative communication services including wireless and voice over internet protocol (VoIP)
 - Nationwide, flat-rate calling plans and other pricing changes instituted by telecommunications carriers.
- There is "churn" in the telecommunications industry with various companies entering and exiting the market. This churn, along with various mergers and acquisitions, poses challenges for the administrators of the Fund. Several companies that were contributing to the Fund have filed bankruptcy during the past 12 months, while others have effectively removed themselves from the market.
- The current process of resizing the Fund results in using revenue data that is more than 18 months old by the time the Fund is resized. In a turbulent sector such as telecommunications, 18 months is excessive and does not allow the Fund to respond rapidly to changes in telephone carriers. A request to shorten the time period for resizing the fund is now pending before the South Carolina Public Service Commission.

Balances Sheets/Statements of Net Assets (Deficit) as of December 31,

	<u>2007</u>	<u>2006</u>
Assets		
Cash and cash equivalents	\$ 4,430,368	\$ 2,193,952
Accounts receivable, less allowance for doubtful accounts in 2007 and 2006 of \$252,919 and \$280,369, respectively	955,876	3,194,079
Due from SCORS	27,605	—
Total assets	<u>\$ 5,413,849</u>	<u>\$ 5,388,031</u>

**Liabilities and Fund Balance (Deficit)/Net Assets
(Deficit)**

Distributions payable	\$ 4,953,334	\$ 5,637,463
Accounts payable	5,673	3,742
Overpayments/credits payable	206,803	582,178
Due to SCORS	35,400	2,738
Other liabilities	2,761	—
Total liabilities	<u>5,203,971</u>	<u>6,226,121</u>

Fund Balance (Deficit)/Net Assets (Deficit)

Unreserved fund balance (deficit)/net assets (deficit)	<u>209,878</u>	<u>(838,090)</u>
Total fund balance (deficit)/net assets (deficit)	<u>209,878</u>	<u>(838,090)</u>
Total liabilities and fund balance (deficit)/net assets (deficit)	<u>\$ 5,413,849</u>	<u>\$ 5,388,031</u>

**Statements of Revenues, Expenditures and Changes in Fund Balance (Deficit)/Statements of
Activities for the years ended December 31,**

	<u>2007</u>	<u>2006</u>
Revenues		
Contributions	\$ 54,580,725	\$ 53,306,102
Late payment assessments	46,771	1,583
Total revenues	<u>54,627,496</u>	<u>53,307,685</u>
Expenditures/Expenses		
Telecommunication service providers	53,322,418	53,270,584
General and administrative expenditures/expenses	257,110	279,336
Total expenditures/expenses	<u>53,579,528</u>	<u>53,549,920</u>
Excess (deficiency) of revenues over (under) expenditures/Changes in net assets (deficit)	<u>1,047,968</u>	<u>(242,235)</u>
Fund deficit/net deficit, at beginning of year	<u>(838,090)</u>	<u>(595,855)</u>
Fund balance (deficit)/net assets (deficit), at end of year	<u>\$ 209,878</u>	<u>\$ (838,090)</u>

Request for Information

The primary purpose of this financial report is to provide a general overview of the Fund's finances and to demonstrate the Fund's accountability for the money it receives and spends. Questions concerning any of the information provided in this report or requests for additional information should be addressed to:

South Carolina Office of Regulatory Staff
Attn: Finance Director
1401 Main Street, Suite 900
Columbia, SC 29201

Financial Statements

South Carolina Universal Service Fund
Balance Sheets/Statements of Net Assets (Deficit)
as of December 31,

	<u>2007</u>	<u>2006</u>
Assets		
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Total liabilities and fund balance (deficit)/net assets (deficit)	<u>\$ 5,413,849</u>	<u>\$ 5,388,031</u>

The accompanying notes are an integral part of these financial statements.

South Carolina Universal Service Fund
 Statements of Revenues, Expenditures and Changes in Fund Balance (Deficit)/
 Statements of Activities
 for the years ended December 31,

	<u>2007</u>	<u>2006</u>
Revenues		
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Fund balance (deficit)/net assets (deficit), at end of year	<u>\$ 209,878</u>	<u>\$ (838,090)</u>

The accompanying notes are an integral part of these financial statements.

South Carolina Universal Service Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

General and Basis of Accounting – On October 10, 2001, the South Carolina Public Service Commission (the “SCPSC”) issued Order No. 2001-996 at Docket No. 97-239-C which approved the final guidelines for the establishment of the Fund. The Fund was established to provide both universally available basic local exchange telephone service at affordable rates and to assist with the alignment of prices and/or cost recovery.

The Fund is funded by an assessment on all telecommunications service providers, with the exception of wireless providers, that provide intrastate and interstate telecommunications services in the State of South Carolina (the “State”) and is paid, via a monthly remittance advice, to the SCORS. Support disbursements from the Fund are made monthly to eligible telecommunication service providers.

The Fund’s financial statements have been prepared in conformity with generally accepted accounting principles for governments as prescribed by the Governmental Accounting Standards Board (“GASB”), for the period presented. The Fund’s financial statement presentation follows the guidelines of GASB No. 34. GASB No. 34, as amended, establishes standards for financial reporting for state and local governments. The Fund is a special revenue fund of the State of South Carolina. These statements present the financial position and results of operations of only the activity of the Fund, and are not intended to present the financial activity for the State of South Carolina.

The Fund is accounted for using the current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are included on the Balance Sheets. The operating statement presents revenues and expenditures that result in changes in net available financial resources.

The Fund is accounted for on the modified accrual basis of accounting, which recognizes revenues when they become measurable and available to pay current reporting period liabilities. Revenues are considered to be available if received within one year after the fiscal year-end. Expenditures and related liabilities are recognized when obligations are incurred.

For the purposes of the Fund, there are no reconciling items between the fund financial statements and the presentation on an entity-wide basis. Accordingly, the financial statements have been presented in a combined format as permitted under GASB No. 34.

Cash and Cash Equivalents – Cash and cash equivalents represent cash on deposit and invested in various instruments by the State Treasurer as part of the South Carolina Local Government Investment Pool (the “Pool”). Because the Pool operates as a demand deposit account, amounts invested in the Pool are classified as cash and cash equivalents.

Accounts Receivable – Receivables are payments due under normal terms requiring payment by the 30th of the month. Any accounts not paid by the 30th of the month are assessed a late payment charge of .0493% per day. Late payment charges are recorded as late payment assessments. Late payments assessed for the years ended December 31, 2007 and 2006, were \$46,771 and \$1,583, respectively.

South Carolina Universal Service Fund
Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

Allowance for Doubtful Accounts – An allowance for doubtful accounts is recorded and reduces the carrying value of accounts receivable to its net realizable value. The amount of the allowance is based upon management's estimate of currently uncollectible accounts, historical trends, current economic trends, and other factors.

Accounting Estimates – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenditures and affect disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenditures during the reporting period. Accordingly, actual results could differ from those estimates.

Revenue Recognition – Telecommunications companies doing business in South Carolina are required to pay to the Fund a fixed monthly amount as determined in accordance with Fund guidelines. It is the Fund's policy to record revenue when the revenue is both measurable and available.

Note 2. Deposits Held by State Treasurer

The deposits of the Fund held by the State Treasurer are under the control of the State Treasurer who, by law, has sole authority for investing State funds. State law requires full collateralization of all State Treasurer balances. The State Treasurer must correct any deficiencies in collateral within seven days.

With respect to investments in the State's internal cash management pool, all of the State Treasurer's investments are insured or registered or are investments for which the securities are held by the State or its agent in the State's name. Information pertaining to carrying amounts, fair value, credit and other risks as required by Governmental Accounting Standards Board Statement No. 40 Deposits and Investments – Risk Disclosures, of the State Treasurer's investments are disclosed in the Comprehensive Annual Financial Report of the State of South Carolina.

Deposits at fair value at December 31, 2007 and 2006 held by the State Treasurer are \$4,430,368 and \$2,193,952, respectively.

Note 3. Income Taxes

These financial statements present the activities of the Fund. The activities of the Fund are tax-exempt since the Fund is a special revenue fund of the state of South Carolina; therefore, not subject to federal or state income taxes or sales, use, gross receipts or other taxes. As such, no provisions for such taxes have been reflected in the accompanying financial statements.

South Carolina Universal Service Fund Notes to Financial Statements

Note 4. Assessments

Identified carriers that are operating in the State of South Carolina, excluding wireless service providers, provide assessments to the Fund. The SCORS searches publicly available resources to identify carriers operating in the state of South Carolina that are not providing assessments to the Fund. The carriers are assessed based upon the weighted average of their total revenues compared to the total revenues of all telecommunication companies operating in the State. The total assessments for the years then ended December 31, 2007 and 2006 were \$54,580,725 and \$53,306,102, respectively.

Note 5. Amounts Paid and Due to Telecommunication Service Providers

Payments to the qualified recipients are made by the South Carolina Treasurer's office as directed by the SCORS. The qualified recipients receive payments in order to neutralize the revenue deficits created by mandated decreases in access charges in addition to high cost support as determined by the SCPSC. For the years ended December 31, 2007 and 2006, the Fund determined that \$53,322,418 and \$53,270,584, respectively in support payments were due to service providers.

Note 6. Related Parties

The Fund is administered by the SCORS as set forth by the State of South Carolina Act 175 of 2004. During the current year, the SCORS incurred general and administration expenditures/expenses totaling \$258,693 related to administration of the Fund and Lifeline/Linkup outreach. Related to these expenditures/expenses, the Fund recorded a payable to the SCORS in the amount of \$35,400 as of December 31, 2007.

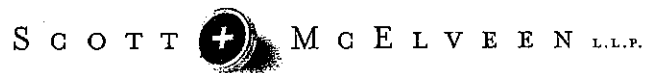
Note 7. Commitments and Contingencies

In 2001 and 2002, the Public Service Commission Orders that established and sized the Fund were appealed by two separate parties. Following a decision in favor of the Fund at the Circuit Court level, the cases were then appealed to the South Carolina Supreme Court. The cases were briefed and argued before the Supreme Court in October 2003. On June 25, 2007, the Supreme Court issued an opinion in which they affirmed the decisions of the Commission. The case has ended, and there are no refunds due or changes to the USF related to that case.

Subsequent appeals have also been filed concerning either sizing or requests for additional funds by the Fund. Previously, these cases had been stayed pending the decision from the Supreme Court in the initial cases discussed above. However, the stays will now be lifted and these cases will be placed on the docket of the Circuit Court for hearing.

The Fund has also received notice of claims from telecommunication companies which have filed for bankruptcy protection in various jurisdictions. Judgment against the Fund in these cases could result in an inability to collect assessed revenues of over \$60,000.

Report on Internal Control Over Financial
Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements
Performed in Accordance with
Government Auditing Standards



**Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters Based
on an Audit of Financial Statements Performed in Accordance with
*Government Auditing Standards***

South Carolina Office of Regulatory Staff
Columbia, South Carolina

We have audited the financial statements of the South Carolina Universal Service Fund (the "Fund") as of and for the years ended December 31, 2007 and 2006, and have issued our report thereon dated October 21, 2008. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Fund's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepting accounting principles such that there is more than a remote likelihood that a misstatement of the Fund's financial statements that is more than inconsequential will not be prevented or detected by the Fund's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Fund's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the South Carolina Office of Regulatory Staff, the South Carolina Public Service Commission and other agencies of the State of South Carolina, and is not intended to be, and should not be used by anyone other than these specified parties.

Scott McElveen, L.L.P.

Columbia, South Carolina
October 21, 2008